

**Family Law Section
Family Law Tax Case Update
11/6/09**

Prepared by Leslie Dawson

Chief Counsel Advice (CCA) 200938022 (9/18/09):

Disclosure requirements on joint returns

This CCA pertains to a taxpayer's duty to disclose participation in a "listed transaction" – i.e. abusive tax shelter scheme. The question is whether both spouses are liable for the penalty imposed by non-disclosure of an abusive Roth IRA transaction, when only one spouse is the participant in the plan.

Under IRC §408(g) – an IRA can only have one owner/beneficiary for tax purposes – even though it may be community property under California law. As such, a spouse is deemed to have no beneficial interest in and no responsibilities for a Roth IRA in the name of the other spouse. Given these circumstances, a spouse should not be held liable for the non-disclosure of an abusive transaction pertaining to the Roth IRA owned by the other spouse. However, if it can be shown that the non-participating spouse received income from the IRA, that spouse may be held liable for non-disclosure.

Estate of Melcher v. Commissioner (TC Memo 2009-210 – 9/15/09):

Legal fees in divorce

This case is a good review of the deductibility of legal fees in a marital dissolution. It discusses the allocation of legal fees as follows:

- Associated with the collection of income – currently deductible
- Associated with the defense of title – capitalize and add to basis
- Associated with the general divorce – personal – no tax benefit

One of the disputes pertained to fees incurred for the sale of a property. There was no allocation between the fees incurred to collect accumulated rents from the former spouse's bankruptcy estate (currently deductible) and the costs to sell the property (capitalize). The resolve, the IRS prepared a simple allocation as follows:

Rent being sought (deduct)	\$1,000,000	16.67%
Sale price of home (capitalize)	<u>\$5,000,000</u>	83.33%
Total funds involved	\$6,000,000	100.00%

The above percentages were applied to the total fees resulting in 1/6th deductible and 5/6th added to basis and factored into the gain or loss from sale.

Smith v. Commissioner (TC Memo 2009-237 – 10/19/09):
Innocent Spouse

Husband established that he was not involved in Wife's business and thus, was unaware of its underreported income. He qualified for innocent spouse relief in all respects except that he actually prepared the tax returns. The business reported losses for four years in a row and the IRS reasoned that Husband should have questioned how the parties were able to finance these losses and maintain their lifestyle.

Molsbee v. Commissioner (TC Memo 2009-231 – 10/8/09):
Innocent Spouse

While Wife was solely responsible for tax penalties since it appears she perpetrated the under-reporting (she served jail time), Husband was responsible for the actual tax since he benefitted from the unreported funds.